

9 Aug 2017

SWIFT NETWORKS GROUP LTD (SW1)

More positive news on two fronts

Recent announcements from Swift Networks ("Company" or "SW1") reaffirmed the strong organic growth story, while also highlighting the inorganic growth opportunities that are available as they continue to cement their industry leading position.

FY17 Preliminary results – Stronger Margins than expected

SW1 provided FY17 Preliminary Results along with its recent 4Q result. Revenue of A\$17m was strong in line with our expectations (Hartleys \$17.03m), however EBITDA of \$1m was materially stronger (Hartleys \$0.65m) with the Company having reached our expected long run Gross Margin level one year ahead of schedule. The Company has highlighted that a resolute focus on renegotiation of content costs and leveraging overheads, coupled with the significant increase in revenue generation, has driven a substantial uplift in SW1's gross margin, increasing by 222% year on year.

Strategic Acquisition of VOD Pty Ltd

The Company also announced a value accretive acquisition of VOD Pty Ltd. Not only does this acquisition provide an accretive boost to earnings but also provides SW1 with a strong foothold in the high growth Hospitality, Healthcare and Education sectors. The \$6m acquisition will increase site numbers by 67% (from 152 to 254) and room numbers by 20,000. The deal will also provide SW1 with an increased presence on the East Coast of Australia and for the first time an overseas presence (12 sites).

Increased Price Target and maintain Speculative Buy

The Company after a period of strong share price appreciation had reached our previous price target of A\$0.36 per share. However, given our upgrade to earnings (as outlined below) on the back of the VOD acquisition and growing opportunities in the Healthcare, Education and Hospitality sectors (in addition to their industry leading position in the resource sector and strong growth already in the Lifestyle / Age care sectors) we upgrade our valuation and price target to A\$0.42 per share (assuming SW1 continues to trade at parity with the ASX IT Services sector). The VOD deal also for the first time provides SW1 with an overseas presence and we view growth in the HEAT sectors (Healthcare, Education, Age Care and Tourism) in the Pacific region of equal or greater opportunity to Australia for SW1.

Given the continued strong organic growth outlook plus the potential for further accretive deals such as VOD, we maintain our Speculative Buy recommendation.

Key Chart: Hartleys Earnings Changes

		FY17 Old	FY17 New	Change	FY18 Old	FY18 New	Change	FY19 Old	FY19 New	Change
Revenue	A\$m	17.03	17.03	0%	22.76	27.58	21%	25.52	32.09	26%
COGS	A\$m	-12.35	-12.01	-3%	-16.16	-19.44	20%	-17.86	-22.46	26%
EBITDA	A\$m	0.65	0.99	52%	2.09	3.54	70%	2.60	4.39	69%
NPAT	A\$m	0.01	0.00	-83%	0.96	1.73	80%	1.27	2.27	79%
Capex	A\$m	-1.20	-0.95	-21%	-1.20	-7.20	500%	-1.20	-1.20	0%
Change Cash	A\$m	-1.79	0.53	-129%	0.65	4.42	582%	0.91	2.36	160%

Source: Hartleys Research

Share Price:	\$0.35
12mth price target:	\$0.42

Brief Business Description:

SW1 provides fully integrated digital entertainment solutions for the Resource, Hotel, Lifestyle village and Aged Care sectors.

Hartleys Brief Investment Conclusion

With a proven product the Company is now well positioned to expand beyond the resource sectors and into other industry verticals such as hospitality, aged care and lifestyle.

Chairman & CEO:

Carl Clump	Chairman (Non Executive)
Xavier Kris	CEO
George Nicholls	CFO

Top Shareholders:	Shares Held (m)
Robert Sofoulis	30.1

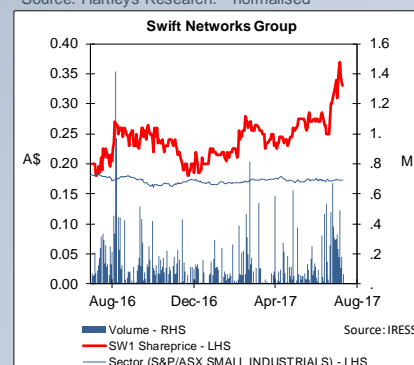
Company Address:

1 Watts Place
Bentley
W.A., 6102

Issued Capital:	73.8m
- fully diluted	168.0m
Market Cap:	\$25.8m
- fully diluted	\$58.8m
Net Cash (post VOD)	\$1.4m

	FY16a	FY17e	FY18e
Screens - end FY	29,604	39,354	68,804
Screen adds	8,054	9,750	29,450
Revenue	14.4	17.0	27.6
EBITDA	-1.5	1.0	3.5
EBIT	-1.8x	0.0x	2.5x
NPAT	-1.8x	0.0x	1.7x
EPS	0.000	0.010	0.014
EV/EBITDA	-38.8x	57.8x	16.2x
EV/EBIT	-32.2x	19,344x	23.2x

Source: Hartleys Research. * normalised



Authors:

Aiden Bradley
Energy & Industrials Analyst
Ph: +61 8 9268 2876
E: aiden.bradley@hartleys.com.au

Hartleys has completed capital raisings in the past 12 months for Swift Networks Group Limited ("Swift Networks") for which it has earned fees. Hartleys has provided corporate advice within the past 12 months and continues to provide corporate advice to Swift Networks for which it has earned and continues to earn fees. Hartleys has a beneficial interest in 3.8 million escrowed options in Swift Networks.

HIGHLIGHTS

Recent announcements from SW1 have reaffirmed the strong organic growth story, while also highlighting the inorganic growth opportunities that are available as they continue to cement their industry leading position.

SW1 provided FY17 Preliminary Results along with its recent 4Q result. Revenue was strong in line with our expectations, however EBITDA was materially stronger.

The Company also announced a value accretive acquisition of VOD Pty Ltd. Not only does this acquisition provide an accretive boost to earnings but also provides SW1 with a strong foothold in the high growth Hospitality, Healthcare and Education sectors.

FY17 Preliminary result – Stronger Margins than expected.

SW1 recently released their 4th quarter and FY17 Preliminary Results. Cash receipts from customers were \$4.8 million in the June quarter, growing 27% compared to the June quarter of FY16. Operational activities generated net cash of \$107,000 during the June quarter, resulting in Swift achieving increasing positive cash flow for the second consecutive quarter. SW1's cash balance at the end of the quarter was \$2.2m (\$2.6m post cash collected on the 4th of July).

SW1 also provided preliminary FY17 numbers. Revenue is expected to be \$17.0m in FY17. This was exactly in line with our forecast of A\$17.03m.

The positive surprise was that EBITDA is expected to \$1.0m, ahead of our forecast of \$650,000.

Fig. 1: Hartleys Earnings Changes post Earnings update (pre-VOD)

		FY17 Old	FY17 New	Change	FY18 Old	FY18 New	Change	FY19 Old	FY19 New	Change
Revenue	A\$m	17.03	17.03	0%	22.76	22.76	0%	25.52	25.52	0%
COGS	A\$m	-12.35	-12.01	-3%	-16.16	-16.05	-1%	-17.86	-17.86	0%
EBITDA	A\$m	0.65	0.99	52%	2.09	2.20	5%	2.60	2.60	0%
NPAT	A\$m	0.01	0.00	-83%	0.96	1.05	9%	1.27	1.28	1%
Capex	A\$m	-1.20	-0.95	-21%	-1.20	-0.95	-21%	-1.20	-0.95	-21%
Change Cash	A\$m	-1.79	0.41	-123%	0.65	1.03	59%	0.91	1.18	30%

Source: Hartleys Research

The Company has highlighted that a resolute focus on renegotiation of content costs and leveraging overheads, coupled with the significant increase in revenue generation, has driven a substantial uplift in SW1's gross margin, increasing by 222% year on year.

As a result, the Company has reached our expected long run Gross Margin level one year ahead of schedule. So, while this has not directly resulted in a material increase to our FY18-19 EBITDA forecasts it does offer potential that our current margin assumptions may be conservative.

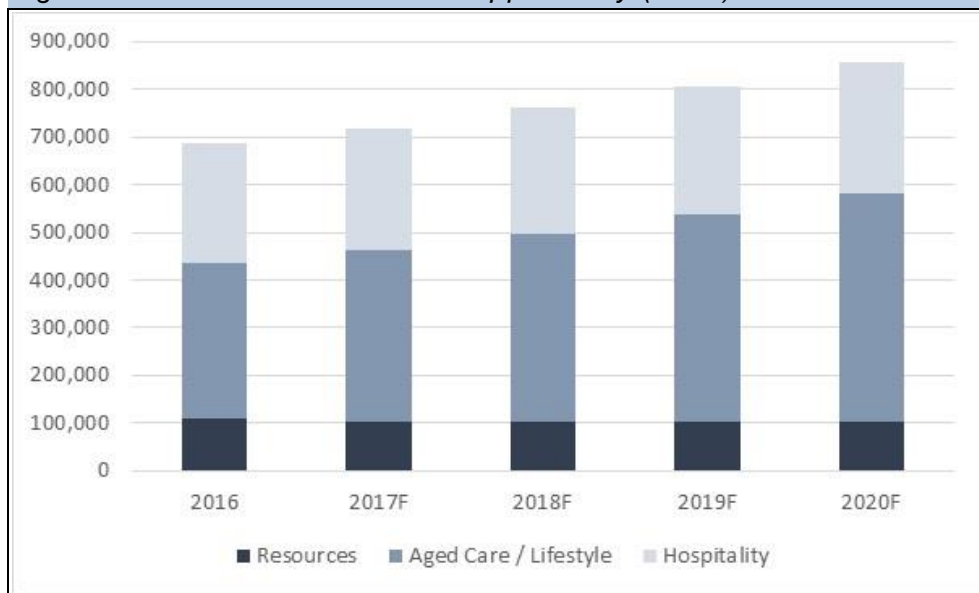
Fig. 2: Revenue and Gross Profit

Source: Hartleys Research

Strategic Acquisition of VOD Pty Ltd

On the 6th of July SW1 announced they executed a binding agreement to purchase Video on Demand, a leading digital entertainment provider in the hospitality sector.

This builds on their market leading presence in the resource sector and recent rapid growth in the Aged Care industry.

Fig. 3: Addressable Market Opportunity (units)

Source: Hartleys Research

The consideration of \$5.1m in cash and \$900,000 in shares will be financed through a \$3m Bankwest debt facility and a \$4.5m equity placement.

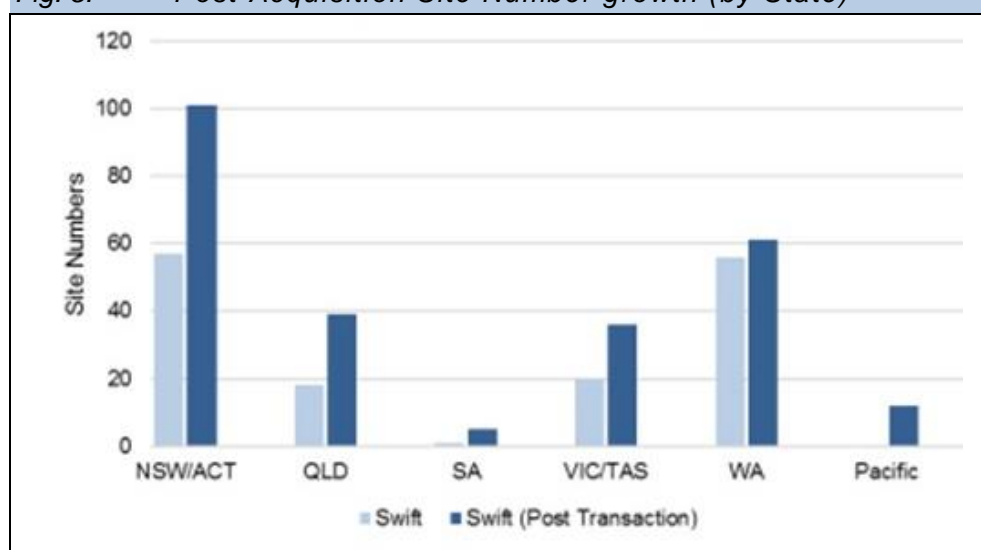
Fig. 4: VOD Deal Structure

Deal Structure @ \$6m valuation	
On completion	\$5,100,000 cash (85%) \$900,000 ordinary shares (15%)
Total Consideration	\$6,000,000
Number of ordinary shares issued at the capital raising price (\$0.25)	
Funding Mix for Acquisition	Cash: • Debt \$3,000,000 • Equity \$4,500,000* Ordinary Shares: \$900,000
Escrow details	25% - Nine (9) months 75% - Twelve (12) months

Source: SW1

The acquisition will immediately increase site numbers by 67% (from 152 to 254) and room numbers by 20,000. The deal will also provide SW1 with an increased presence on the East Coast of Australia and for the first time an overseas presence (12 sites).

Fig. 5: Post-Acquisition Site Number growth (by State)



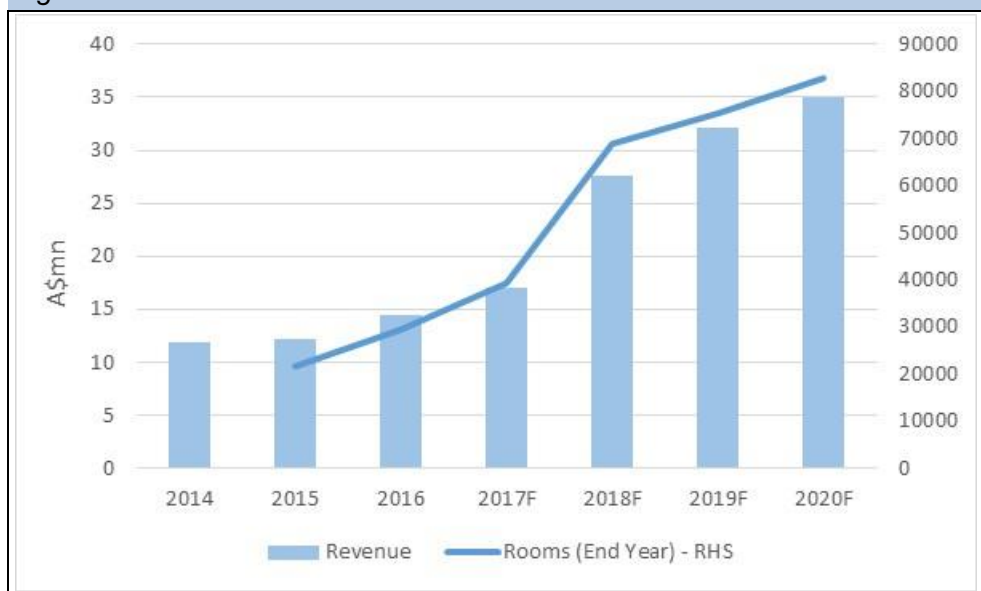
Source: Hartleys Research

The timetable for the deal is as follows;

- First week of July 2017: Execute Share Purchase Agreement, ASX announcement
- 11 August 2017: EGM to approve transaction
- 31 August 2017: Acquisition completion
- 31 October 2017: Businesses fully integrated from a technical and operational standpoint

While VOD's revenue per room lags SW1, the increased footprint once again does allow SW1 to upsell its product suite to this acquired customer base. VOD is a market leader in the provision of IPTV and video-on-demand services and brings with it over 15 years of industry experience in the hospitality sector in addition to material agreements in the growing student accommodation sector, amongst others.

Fig. 6: Revenue and Room Numbers



Source: Hartleys Research

Fig. 7: Services – VOD and Swift Networks

SERVICES	VOD	Swift Networks
Movies on Demand	✓	✓
IPTV System	✓	✓
Digital Signage	✓	✓
Internet Gateway System	✓	✓
Digital Concierge	✓	Improved product offering
Digital Schedule System	✓	

Source: SW1

The acquisition provides SW1 with a strong foothold in the high growth Hospitality, Healthcare and Education sectors.

Fig. 8: Sector Exposure – VOD and Swift Networks

VERTICALS	VOD	Swift Networks
Hospitality	✓	✓
Resources	✓	✓
Lifestyle/Retirement Villages	✓	✓
Aged Care	✓	✓
Student Accommodation	✓	Emerging market growth (3,000+ rooms)
Hospitals	✓	

Source: SW1

Fig. 9: VOD Number of Subscribers

Number of subscribers	FY 17 Annualised 26,631	%
PPV Movies	2,243	8%
Software Connections	4,764	19%
Hotels	8,247	31%
Aged Care	304	1%
Student Accommodation	1,883	7%
Mining	7,785	29%
Hospitals	1,405	5%

Source: SW1

VOD has a history of solid financial performance, with FY17 pro EBITDA of more than \$1.1 million on revenue (unaudited) of \$3.75 million.

The acquired Cost per Subscriber was circa \$231 of recurring revenue.

Fig. 10: VOD FY17 Recurring Revenue

Recurring Revenue (excluding Project Revenue)	FY 17 Annualised* \$2,102,826	%
PPV Movies	\$174,832	8%
Software Connections	\$128,638	6%
Hotels	\$1,003,583	48%
Aged Care	\$45,388	2%
Student Accommodation	\$157,852	7%
Mining	\$474,343	23%
Hospitals	\$118,189	6%

Source: SW1

In addition to the revenue synergy potential the increased scale will likely lead to cost savings to both overhead and operational expenditures. The Company expects the acquisition to allow “Swift to move up the content value chain with a notable reduction in content costs which are a material component of Swift’s overall cost base”.

Fig. 11: VOD Financials FY15-17e

VOD Financials (\$ AUD)	FY 2015 (A)	FY 2016 (A)	FY 2017 (F)
Revenue	2,552,087	3,751,537	3,745,567
COGS	(1,009,536)	(1,686,661)	(1,591,974)
Gross Margin	1,542,551	2,064,876	2,153,593
Overheads	(1,235,921)	(1,426,792)	(1,516,743)
EBITDA	306,630	638,084	636,850
Addbacks	N/A	N/A	479,508
EBITDA (Pro forma)	306,630	638,084	1,116,358

Source: SW1

The potential revenue and cost saving opportunity has resulted in a material uplift to both our revenue and profit forecasts.

Fig. 12: Hartleys Earnings Changes Post Guidance and VOD Acquisition

		FY17 Old	FY17 New	Change	FY18 Old	FY18 New	Change	FY19 Old	FY19 New	Change
Revenue	A\$m	17.03	17.03	0%	22.76	27.58	21%	25.52	32.09	26%
COGS	A\$m	-12.35	-12.01	-3%	-16.16	-19.44	20%	-17.86	-22.46	26%
EBITDA	A\$m	0.65	0.99	52%	2.09	3.54	70%	2.60	4.39	69%
NPAT	A\$m	0.01	0.00	-83%	0.96	1.73	80%	1.27	2.27	79%
Capex	A\$m	-1.20	-0.95	-21%	-1.20	-7.20	500%	-1.20	-1.20	0%
Change Cash	A\$m	-1.79	0.53	-129%	0.65	4.42	582%	0.91	2.36	160%

Source: Hartleys Research

The assumption of \$3m of debt (instead of alternatively issuing a further 12m shares at \$0.25) we also believe is supportable given the EBITDA likely to be generated by the combined businesses over the next few years and the accretive nature of the transaction itself.

Fig. 13: Pro-forma Capital Structure

Pro-forma Capital Structure	On Completion
Existing Ordinary Shares on Issue	90,212,903
Class A Performance Shares	16,666,667
Class B Performance Shares	16,666,667
Performance Shares (other)	4,444,444
Swift Capital Structure pre-acquisition	127,990,681
Cash on Completion (\$4,500,000 @ \$0.25)	18,000,000
Ordinary Shares on Completion (\$900,000 @ \$0.25)	3,600,000
Swift Capital Structure post-acquisition	149,590,681
Existing options	18,373,333
Swift Capital Structure Fully Diluted	167,964,014

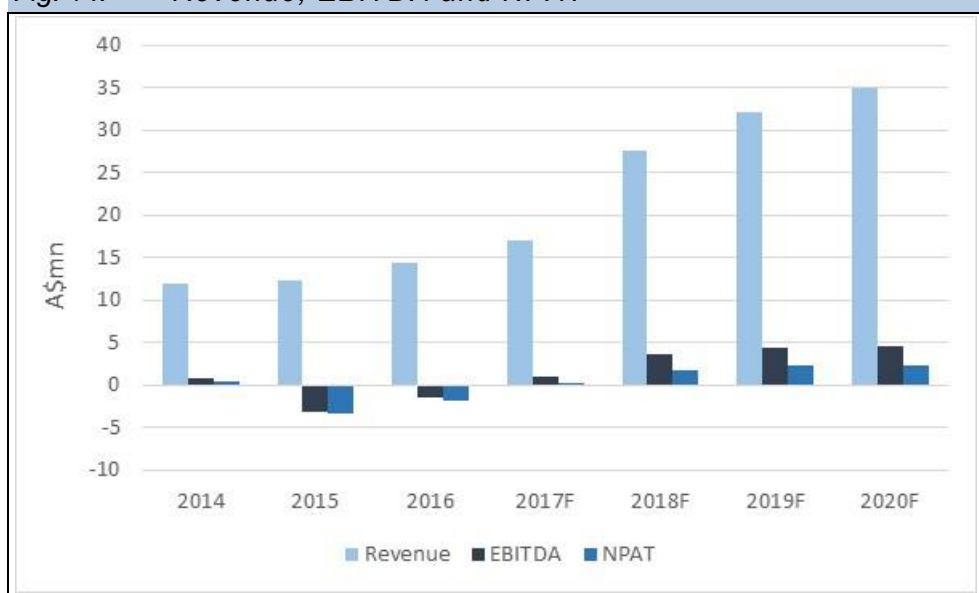
Source: SW1

INVESTMENT VIEW, VALUATION AND PRICE TARGET

Why we like SW1? 1: Resource Sector Cycle Has Bottomed

SW1 has established an industry leading position in the supply of in room entertainment systems to the resource and energy industry in Australia. However, market conditions for this sector have slowed in recent years and with it the outlook for SW1 revenue growth (until recently the Company was solely focused on the resource sector). While we do not forecast significant near-term growth from this sector, we do believe that the resource sector capex cycle has bottomed at least in WA. This provides SW1 with a strong revenue base (covering all Corporate costs) from which to expand into new higher growth markets.

Fig. 14: Revenue, EBITDA and NPAT



Source: Company and Hartleys Research

and 2: Exposure to Aging Demographic and Tourism

SW1 have a proven track record over a number of years in the challenging resource sector, and this experience provides confidence they can make substantial inroads into both the fast-growing hospitality and lifestyle/age care sectors. Recent strategic acquisitions in the latter has expanded their geographical footprint and opened doors to key customers. While this expansion is still in its infancy, the potential is simply enormous.

Fig. 15: Addressable Market Opportunity (units)

Source: Hartleys Research

The acquisition of VOD has further strengthened SW1's presence in the hospitality sector (with key clients such as Accor Hotels and IHG) while providing a strong foothold in the Education and Healthcare sectors. The VOD deal also for the first time provides SW1 with an overseas presence and we view growth in the HEAT sectors (Healthcare, Education, Age Care and Tourism) in the Pacific region of equal or greater opportunity to Australia for SW1 longer term.

Valuation – New Sector Growth key to Upside

SW1 has achieved strong growth and market penetration in the resource sector which has in turn provided the cash flow to build a leader within its industry. To date however in building the platform and Company has consumed this cash and in 1H17 the Company turned a profit. Therefore, looking forward top line unit growth should translate to strong EBITDA and NPAT growth and we feel comfortable that SW1 should 'at least' trade on the multiples of the also fast growing ASX IT Services sector. We also view SW1 as an attractive takeover target for a larger Group focusing on similar sectors and clients. Hence our inclusion of a 'synergy value' also in our valuation. The Company after a period of strong share price appreciation had reached our previous price target of A\$0.36 per share. However, given the increase to our forecasts as outlined in our note (and still assuming parity with the ASX IT Services sector) we now view fair value (and set out target price) at A\$0.42 per share. We maintain our Speculative Buy recommendation.

Fig. 16: Valuation Multiples

Valuation				
ASX IT Peer Group Multiples				
	12M forward - Target Multiple	Wgt.%	Tgt Price	
EV/EBITDA	13x	60%	0.35	
Earnings	22x	20%	0.27	
DCF		20%	0.21	
Synergy/Cost Out			0.12	
Valuation			\$0.42	
Upside / downside from current share price			21%	

Source: Hartleys Research

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

We maintain our **Speculative Buy** recommendation on SW1. We upgrade our valuation to A\$0.42 (from \$0.36) and continue to assume that SW1 will continue to win contracts and acquire customers (cheaply) in the Hospitality, Education, Healthcare and Aged care / Lifestyle Village sectors. Overseas growth is also a highly likely positive catalyst in the coming years as the product offering is easily transferable to overseas markets that are also experiencing rapid development in these industry segments. Looking forward top line unit growth should translate to strong EBITDA and NPAT growth and we feel comfortable that SW1 should 'at least' trade on the multiples of the also fast growing ASX IT Services sector. We note that the product is mature and therefore capital can be used to win new contracts rather than being spent on product development. Key risks to our thesis include a slower than expected penetration into new industry verticals and an increase in the cost of content.

RISKS

An inability to penetrate other industry verticals, outside of the resources sector is a risk to our investment thesis. SW1 has a proven track record of gaining significant market share in the resources sectors but is in the relatively early stages of penetrating other target markets.

An increase in the cost of content is a key risk for SW1. The Company should be commended at negotiating content agreements that do not include minimum subscriber hurdles. Should any of the key content providers, such as Foxtel and providers of movie content, decide to change their pricing structure then SW1 may suffer margin erosion.

SIMPLE S.W.O.T. TABLE

Strengths	Dominant market share in the Australian resource market for the provision of telecommunication and entertainment systems.
Weaknesses	<p>Product development complete. The product is fully developed and requires only minimal capital to update systems.</p> <p>Majority of revenue is still generated from a single industry vertical (resources), although the Company is diversifying rapidly.</p>
Opportunities	<p>The majority of revenue is still generated from W.A., acquisitions such as VOD are also diversifying this exposure.</p> <p>Resources: Opportunity to continue to gain market share in the resource sector and be well positioned for an upturn in the capital expenditure cycle.</p> <p>Hospitality: An opportunity exists for SW1 to win additional contracts from hotel chains both in Australia and offshore.</p> <p>Lifestyle Village/Age Care: An aging population is likely to drive increased demand for aged care and lifestyle facilities in Australia.</p> <p>Overseas: There is real scope for SW1 to transfer its success in Australia to much larger overseas markets.</p>
Threats	<p>Large media and telco's, such as NTT DoCoMo will be difficult to replace with major hotel chains.</p> <p>A significant increase in the cost of content and or the pricing structure of content represents a risk for SW1.</p>

Source: Hartleys Research

HARTLEYS CORPORATE DIRECTORY

Research

Trent Barnett	Head of Research	+61 8 9268 3052
Mike Millikan	Resources Analyst	+61 8 9268 2805
John Macdonald	Resources Analyst	+61 8 9268 3020
Paul Howard	Resources Analyst	+61 8 9268 3045
Aiden Bradley	Research Analyst	+61 8 9268 2876
Michael Scantlebury	Junior Analyst	+61 8 9268 2837
Janine Bell	Research Assistant	+61 8 9268 2831

Corporate Finance

Dale Bryan	Director & Head of Corp Fin.	+61 8 9268 2829
Richard Simpson	Director	+61 8 9268 2824
Ben Crossing	Director	+61 8 9268 3047
Ben Wale	Associate Director	+61 8 9268 3055
Stephen Kite	Associate Director	+61 8 9268 3050
Scott Weir	Associate Director	+61 8 9268 2821
Scott Stephens	Associate Director	+61 8 9268 2819
Rhys Simpson	Manager	+61 8 9268 2851

Registered Office

Level 6, 141 St Georges TcePostal Address:

PerthWA 6000 GPO Box 2777
 Australia Perth WA 6001
 PH: +61 8 9268 2888 FX: +61 8 9268 2800
 www.hartleys.com.au info@hartleys.com.au

Note: personal email addresses of company employees are structured in the following manner:firstname.lastname@hartleys.com.au

Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative Buy	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

Institutional Sales

Carrick Ryan	+61 8 9268 2864
Justin Stewart	+61 8 9268 3062
Simon van den Berg	+61 8 9268 2867
Chris Chong	+61 8 9268 2817
Digby Gilmour	+61 8 9268 2814
Tia Hall	+61 8 9268 3053

Wealth Management

Nicola Bond	+61 8 9268 2840
Bradley Booth	+61 8 9268 2873
Adrian Brant	+61 8 9268 3065
Nathan Bray	+61 8 9268 2874
Sven Burrell	+61 8 9268 2847
Simon Casey	+61 8 9268 2875
Tony Chien	+61 8 9268 2850
Tim Cottee	+61 8 9268 3064
David Cross	+61 8 9268 2860
Nicholas Draper	+61 8 9268 2883
John Featherby	+61 8 9268 2811
Ben Fleay	+61 8 9268 2844
James Gatti	+61 8 9268 3025
John Goodlad	+61 8 9268 2890
Andrew Gribble	+61 8 9268 2842
David Hainsworth	+61 8 9268 3040
Murray Jacob	+61 8 9268 2892
Gavin Lehmann	+61 8 9268 2895
Shane Lehmann	+61 8 9268 2897
Steven Loxley	+61 8 9268 2857
Andrew Macnaughtan	+61 8 9268 2898
Scott Metcalf	+61 8 9268 2807
David Michael	+61 8 9268 2835
Jamie Moullin	+61 8 9268 2856
Chris Munro	+61 8 9268 2858
Michael Munro	+61 8 9268 2820
Ian Parker	+61 8 9268 2810
Matthew Parker	+61 8 9268 2826
Charlie Ransom	+61 8 9268 2868
Mark Sandford	+61 8 9268 3066
David Smyth	+61 8 9268 2839
Greg Soudure	+61 8 9268 2834
Sonya Soudure	+61 8 9268 2865
Dirk Vanderstruyf	+61 8 9268 2855
Samuel Williams	+61 8 9268 3041
Jaime Walsh	+61 8 9268 2828

Disclaimer/Disclosure

The author of this publication, Hartleys Limited ABN 33 104 195 057 ("Hartleys"), its Directors and their Associates from time to time may hold shares in the security/securities mentioned in this Research document and therefore may benefit from any increase in the price of those securities. Hartleys and its Advisers may earn brokerage, fees, commissions, other benefits or advantages as a result of a transaction arising from any advice mentioned in publications to clients.

Hartleys has completed capital raisings in the past 12 months for Swift Networks Group Limited ("Swift Networks") for which it has earned fees.

Hartleys has provided corporate advice within the past 12 months and continues to provide corporate advice to Swift Networks for which it has earned and continues to earn fees. Hartleys has a beneficial interest in 3.8 million escrowed options in Swift Networks.

Any financial product advice contained in this document is unsolicited general information only. Do not act on this advice without first consulting your investment adviser to determine whether the advice is appropriate for your investment objectives, financial situation and particular needs. Hartleys believes that any information or advice (including any financial product advice) contained in this document is accurate when issued. Hartleys however, does not warrant its accuracy or reliability. Hartleys, its officers, agents and employees exclude all liability whatsoever, in negligence or otherwise, for any loss or damage relating to this document to the full extent permitted by law.